ASIAN DEVELOPMENT

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Executive Summary

ASIAN DEVELOPMENT

Economic Success and Policy Lessons

by
William E. James
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International Center for Economic Growth

Affiliated with the
Institute for Contemporary Studies

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Preface

This fourteen-country comparative study is the result of a multi-year project at the Asian Development Bank in Manila and at the East-West Center in Honolulu. In its comparative examination of three groups of countries, the authors look both at Asia's success stories—to which so much deserved attention has been directed recently—and at cases that have been far less successful.

This is the Center's third collection of country studies, following Arnold Harberger's edited *World Economic Growth: Case Studies of Developed and Developing Nations* (1984), and Lawrence Lau's edited *Models of Development: A Comparative Study of Economic Growth in South Korea and Taiwan* (1986). This study, like the other two, focuses on issues of major interest to the Center, especially the relationship between policy and growth, and impacts on human welfare. Its broad conclusions are also consistent with the other studies in finding that policies encouraging growth, which are generally supported by policy professionals, also encourage human development and human welfare.

This is an executive summary of the original book published by ICEG.

Nicolás Ardito-Barletta
General Director
International Center
for Economic Growth

Panama City, Panama
1988

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Executive Summary

The unprecedented success of growth and development in the countries of Asia is one of the most important events in economic history. Since the 1960s, some developing Asian countries have been able to accelerate their progress and through high rates of economic growth are beginning to catch up with Europe, Japan, and the United States. ***Asian Development*** addresses how and where this growth occurred and what is necessary to continue the Asian economies' exemplary performance.

Successful growth and development have been determined primarily by the quality of a country's national economic management. Progress has been the most substantial where domestic policies encourage the efficient use of resources and promote private sector initiatives. Foreign aid has played a catalytic role in pushing policies in the right direction and contributing a number of resources to the development effort.

Asian Development analyzes the experiences of fourteen countries, clustered in three groupings. It studies:

- the Asian newly industrializing countries (NICs) of Hong Kong, Korea, Singapore, and Taiwan;
- the resource-based ASEAN-4 countries of Indonesia, Malaysia, the Philippines, and Thailand; and
- the low-income countries of South Asia—Bangladesh, Burma, India, Nepal, Pakistan, and Sri Lanka.

Among these groups recent development strategies and policies have differed dramatically. The distinguishing features are as follows:

- The NICs have attained the highest rates of growth. Their economic policies are the most open and market-oriented. They have moved from agriculture to industry and services, shifting from import substitution to export orientation. They have high levels of employment, entrepreneurial opportunity, and broad income distribution, and are now among the most egalitarian countries in the world.
- ASEAN-4 growth and structural transformation has also been impressive, but not so dramatic as the NICs. The ASEAN countries have had less export orientation in their industries, and government interventions have tended to promote a capital-intensive industrial pattern that has not generated sufficient employment.
- South Asian countries have improved their conditions the least. Their policies have been more inward-looking and interventionist than the other Asian countries. Achieving better growth rates and generating more employment opportunities are prerequisites to the lessening of abject poverty in this area, although growth in some countries—Pakistan, Sri Lanka, and India—has improved.

Six aspects of the overall development strategies of the three groups of Asian countries can be highlighted:

1. Successful outward-looking development strategies also involved a market- or private-sector-oriented approach. Countries that tried to replace the market through direct controls generally had inferior records of development.
2. Price distortions in the national economies were necessarily reduced to correspond to conditions in the world economy. Correcting distortions achieved a more efficient allocation of resources, increased employment, stimulated production of scarce goods, avoided arbitrary bureaucratic decisions, and averted delay, ideological bias, and corruption.

3. Prudent macroeconomic policies and management went hand in hand with controlling budget deficits and restraining excessive demand and inflation. Financial development combined with low rates of inflation and rapid growth encouraged high rates of resource mobilization and increased investment rates.

4. The most successful Asian countries gave priority to economic growth over social welfare spending. Active redistribution policies played only a minor role. Economic growth increased the market demand for labor and helped to spread the benefits of growth.

5. The combination of outward-looking, market-oriented policies and cautious macroeconomic management gave the most successful Asian developing countries a great deal of flexibility. Policymakers were able both to analyze their development plans and to adjust strategies where necessary.

6. Education has been a key element in explaining economic growth. In general, the most successful countries have had the highest school enrollment ratios and the lowest drop-out rates. The positive impact of sound educational programs provides powerful arguments for greater investments in learning.

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Characteristics of Asian Development

Industrialization and Trade Policies

The distinguishing feature of industrialization in Asian developing countries is the shift from import-substitution policies to export orientation. The NICs were able to see that producing goods exclusively for a domestic market would not allow for adequate growth, and they adopted an export-oriented strategy. As a result, they have been among the most trade-oriented countries in the world.

Other Asian developing countries have followed the NICs' lead. Originally, the ASEAN-4 had economic and political constraints encouraging them to follow more restrictive trade policies, designed to foster industries producing for the domestic market. But in the 1970s, the ASEAN began to adopt a more export-oriented approach and growth of exports and output increased rapidly.

South Asian countries, especially Sri Lanka and India, have moved toward export orientation even more recently.

The Industrial Sector Grows, the Agricultural Sector Declines. During the 1970s, industrial sectors (manufacturing, mining, construction, and public utilities) made substantial contributions to economic development by accelerating their total income growth, by expanding opportunities for productive and remunerative employment, and by easing balance-of-payments problems. Manufacturing GDP, on average, grew more than twice as fast in the NICs and ASEAN-4 (over 10 percent) as in Latin America and over three times as fast as in Africa between 1973 and 1984.

At the same time, the share of agriculture in GDP has been continuously declining. The progress made in shifting the labor force out of agriculture and into industrial jobs has varied widely among the regions. In the NICs, high rates of industrial growth have led to rapid growth of employment. In the ASEAN-4 countries, the growth rate of industrial employment has barely exceeded that of the labor force as a whole, and the share of industrial employment remained low. Although the larger South Asian countries had a substantial industrial base by the 1970s, the performance of the industrial sector as a whole was below the average for the Asian region in terms of both output growth and employment generation.

The Newly Industrializing Countries. Nowhere in the world has the growth of trade and the industrial sector played as critical a role as in the NICs of Asia. The economies of Taiwan and Korea, in particular, underwent fundamental structural changes in a remarkably short time. These countries are now so thoroughly identified as exporters of manufactured goods that it is hard to remember that only a few decades ago they were predominantly agricultural. The NICs' success is due to many factors, but their outward-looking industrialization strategies are an essential component. Industries were pushed to become internationally competitive; firms were expected to produce goods of comparable quality and price to imports and to begin exporting within a few years. The requirement to produce at world market prices prevented proliferation of excessively capital-intensive activities.

The NICs depended on labor-intensive manufactures and their highly elastic supply of low-cost semi-skilled labor. Two-thirds of their industrial expansion was generated through added industrial employment. In Korea and Taiwan, the industrial sector completely absorbed the annual rise in the labor force and also drew labor from other sectors. From the 1970s on, there has no longer been a labor surplus. The increase in industrial employment has allowed all workers to share the benefits of rapid economic growth, especially in Taiwan.

Beginning in the mid-1970s, the prospects for future NIC development became less favorable, and their governments instituted new policies aimed at diversifying industrial exports by shifting production toward technology-intensive and heavy industrial activities.

Overall, slower real economic growth has accompanied the recent industrial strategy of the NICs. Some of the policy changes reduced economic efficiency even as the external economic environment became more hostile. The NICs' industrial development will continue to be export oriented because of the limited size of their domestic markets and their poor natural resource endowments, which create a high dependency on imported raw materials and energy. But protectionism against their traditional labor-intensive and semiskilled products, increasing wage rates as a result of full employment of the labor force, and emerging competition from more labor-abundant countries will probably check further export growth in products such as textiles and clothing.

Development of the NICs' domestic markets for consumer durables, housing, and discretionary spending could increase demand for many new products and services. Such expansion seems inevitable because incomes and consumer spending power have risen substantially, while the quality of housing and ownership of durables such as automobiles, color television, videocassette recorders, and refrigerators have lagged. As income continues to grow in the larger NICs, domestic industrial growth in sophisticated sectors, e.g., microcomputers, electrical appliances, and home furnishings, can expand and strengthen overall industrial growth. Hong Kong and Singapore cannot rely much on domestic market expansion because of their small size, but both may continue to boost their industrial sectors by capturing a share of the expanding China market.

ASEAN-4. The ASEAN-4 policy package involved the selective protection of domestic producers against foreign competition by raising domestic output prices above world market prices. Tariffs, import quotas, and surcharges were frequently used. Typically, the highest levels of protection were granted to finished goods, the lowest to raw materials and primary products.

Indonesia, the largest ASEAN country in population and land area, has a history of widespread government intervention, ownership, and regulation, and it has had the most inward-looking policies. Though the present government has partially dismantled the import licensing and exchange controls of the Sukarno regime's "guided economy," it still makes much use of nontariff trade barriers and price controls.

In contrast, Malaysia has had few nontariff trade restrictions. The overall simple average tariff rate is quite low, though there is a wide dispersion of individual tariffs. The Philippines and Thailand are intermediate cases—though in the 1970s Thailand's tariffs were substantially lower than those of the Philippines. Both countries have resorted extensively to nontariff barriers, with fairly high nominal tariff rates for manufactures.

Unlike the NICs, about two-thirds of industrial output growth in the ASEAN-4 countries came from higher output per worker and only one-third from more employment in the 1970s. Employment in manufacturing grew at less than 5 percent annually in the 1970s, except for Malaysia. The increments to employment were not sufficient in most countries to ease the burden of either rural or urban surplus labor.

In the second half of the 1970s, the governments of the oil-importing countries (the Philippines and Thailand) tried to increase manufactured exports. Export controls were relaxed, export taxes abolished or reduced. Changing from inward- to outward-oriented industrialization is a lengthy process, and it is premature to make a final judgment on the long-term effects of these policy changes, but some general conclusions are possible.

In the ASEAN countries, the new policies favoring manufactured exports were adopted with some tariff cuts but without substantial reductions in nontariff barriers. Hence, discrimination against exports was only partly mitigated by the new measures. The incentive structure favoring capital-using industrial activities remained basically unchallenged.

Malaysia, however, seems to have been more successful. Several free-trade zones (FTZs) were set up with rapidly expanded production of textiles and electronic goods. Scattered evidence suggests that Malaysia's added industrial employment was created mainly in the FTZs; by 1982, over half of manufacturing exports originated there. Hence, the notable overall performance of Malaysia's manufacturing was based to a considerable degree on footloose production in the FTZs where multinational corporations dominate.

Despite their success to date, the long-term viability of the FTZs is debatable. Recent evidence, however, concludes that the benefits of FTZs have exceeded their costs. Still, efforts to better integrate FTZ firms into the economy have been hindered by the failure of domestic industries to make good-quality locally processed materials and equipment reliably available to FTZ firms. Regulations that limit the sale of FTZ goods in domestic markets on an equal footing with imports have also prevented integration.

The rapid depletion of some of the ASEAN's rich natural resources has led to recent restrictions on some exports. For example, there are restrictions on log exports in Malaysia, the Philippines, and Indonesia.

The sharp and prolonged decline in prices of primary products in the 1980s emphasizes the importance of export diversification. If the natural-resource-rich countries are to continue their successful growth performance and increase employment in their industrial sectors, they must continue with major reforms to improve efficiency in resource use and international competitiveness. At the firm level, the changes must include a new output mix, new production technologies to conserve energy, and higher product quality standards.

The prospects for increased manufactured exports from Southeast Asian countries look favorable, even if existing trade barriers remain. As the NICs lose their comparative advantage in unskilled labor-intensive goods due to rising wage levels, countries at lower levels of industrial development can gradually replace the NICs in exporting to countries within Asia and to the OECD nations. And high wage rates in OECD countries encourage the relocation of labor-intensive parts of production to countries with low wage levels and a work force sufficiently skilled to assure reasonable labor productivity. These competitive conditions exist in Southeast Asia and in some South Asian countries.

South Asia. A pattern of inward-looking, autarkic industrial development became widespread in South Asia in the 1950s, 1960s, and even early 1970s for some countries. Public enterprises were believed to be better agents for government policies than were private enterprises. Hence, industrial development came to be mainly controlled by large state-owned corporations. The private sector now consists primarily of cottage and small-scale traditional industries. Privately owned industrial enterprises have been discouraged; subsidized credit and other privileges are granted first, and often exclusively, to firms in the public sector.

The performance of public enterprises has all too often been unsatisfactory. They have suffered from management inefficiencies and bureaucratic impediments, and have been burdened with executing too many government policies. Such varied tasks have undermined the economic viability of public enterprises. Heavy expenditures have often been needed to sustain them.

A major rationale for extensive controls has been the desire of government policymakers to protect the poor But South Asian populist governments calling for poverty amelioration and greater income equality had distinctly worse performance with regard to the poor than regimes seeking higher rates of economic growth through pro-growth policies.

Inefficient public enterprises, distorted prices, and bureaucratic rigidities have led to high cost, low-productivity, and a reluctance to invest. The resulting limited foreign capital inflow, lack of international competitiveness, and overvalued currencies cause recurrent foreign exchange shortages. Adjustment has been impeded by government policies favoring large-scale, physical capital-intensive and technology-intensive industries, and by artificially increased wage costs and employment guarantees to employees of public enterprises.

Overall, industrialization strategy in South Asia has placed heavy demand on scarce factors (skills and capital), and has made little use of unskilled labor. The result has been predictable: slow growth of output and industrial employment. But the policy direction has begun to change toward more market-oriented policies. Discrimination against private enterprise is being reduced, and more efficient management of public industrial enterprises is being sought. Sectoral priorities are also being reconsidered: more emphasis is being given to production for export and to unskilled labor-intensive manufactures.

Appropriate strategies differ widely between large countries with well-established industrial sectors like India and much less-developed economies like Bangladesh, but there is potential everywhere for more efficient use of domestic resources.

Issues for Future Industrial Development. All of the Asian developing countries will have to achieve major industrial reforms in order to improve their efficiency of resource use and the international competitiveness of their manufacturing industries. There are four strategies they must follow.

1. They must first make better use of their current and prospective comparative advantage in industrial production.
2. They must promote regional dispersion of industries and develop efficient small- and medium-scale enterprises.
3. They must improve domestic resources—by increasing and better allocating domestic savings, and by furthering education, on-the-job training, and the development of entrepreneurial skills.
4. Finally, they must dismantle administrative obstacles to industrial expansion, particularly overly restrictive trade and investment regulations.

Domestic Savings Performance

Saving and investment rates increased sharply throughout Asia during the 1970s, and by 1985, over 80 percent of gross domestic investment was financed by domestic savings in the Asian LDCs. Domestic saving rates averaged nearly 30 percent of GDP in the NICs and ASEAN-4. For South Asia, the rates averaged only about 11 percent, with wide variations among the countries. Through great effort, India raised its domestic saving rate to 20 percent in the 1980s. The means by which Asian countries increased domestic savings rates varied considerably. Most domestic savings were generated by the private sector, especially by households. In the 1970s government saving (the excess of current revenues over current expenditures) in less-developed Asian countries averaged less than 3 percent of gross domestic savings. Substantial fiscal efforts raised tax revenue as a percent of GDP, but in most cases governments expenditures increased almost as much, so that the contribution of governments to domestic saving remained small.

Throughout the 1970s domestic saving rates continued to rise in the NICs and ASEAN-4, as well as in Burma, Nepal, and India. Those rates fell in Thailand and the Philippines in the 1980s, however, and fell or remained low in much of South Asia.

The Asian emphasis on domestic saving is partly a reaction to harder external financial conditions and to external debt problems. The excellent savings performances of the NICs, the ASEAN-4 countries, and India have been a major ingredient in raising investment rates, but more efficient financial intermediation will be important in supporting further rapid growth in other Asian nations. This need is being handled in different ways by different countries, but in general the outlook is for greater reliance on market forces and private initiative.

Investment rates varied less than domestic saving rates in Asia because of the availability of foreign savings during the 1970s and early 1980s. Remittances from workers employed in the Middle East became an important new source of savings for oil-importing Asian countries, for they augmented domestic incomes and savings, as well as foreign exchange and government revenue. National saving rates in Pakistan and Bangladesh, for example, are far higher than domestic saving rates because of these remittances.

Within each subgroup of countries, differences in real GDP growth were not due to differences in saving and investment rates. Other influences on incremental output—the types of investments made, changes in other inputs, skills, and organizational improvements—often were dominant in determining growth. The Philippines, for example, had saving and investment rates higher than Thailand's but still grew more slowly from 1970 to 1980. India, which saved and invested a higher proportion of GNP than any other country in South Asia, had at best a mediocre growth performance. In the late 1970s and early 1980s, Pakistan achieved a real GDP growth rate nearly twice that of India's, with an investment rate that was only two-thirds as high.

Financial Institutions and Development Experience. In almost all Asian countries, governments to a greater or lesser degree have intervened in the allocation of credit, believing that market forces alone would not satisfy development priorities. These interventions have almost always included the establishment of state-owned financial institutions, and some governments have even gone so far as to nationalize private banks. Only in Hong Kong has intervention been confined to purely regulatory functions.

Other financial policies adopted by governments, however, have been very different. In the NICs and Malaysia, government policies have provided incentives to depositors since the 1960s. Inflation rates have been low and interest rates high enough to provide a positive real return on deposits. Financial institutions, public and private, grew and became more efficient. Investment increased in amount and quality as government policies encouraged term lending to industrial enterprises. In short, government interventions strengthened financial markets and helped promote financial development.

In other countries, government policies during the 1960s and 1970s often held interest rates at unrealistically low levels. There was less success in mobilizing savings deposits. Financial institutions were used to provide large established private business groups and the government with cheap credit. Shortages of funds and the preference of financial institutions for low-risk lending made it difficult for smaller or newer enterprises and farmers to obtain bank credit. Financial dualism worsened as government policies amounted to financial repression.

To correct this, governments set up new institutions. But a major shortcoming of these financial development efforts in most countries of South Asia and the ASEAN-4 was the one-sided emphasis on improving the financial sector's ability to disburse credit. Little attention was given to measures aimed at encouraging growth of private savings deposits.

Financial Sector Growth and Change. The growing reach of financial systems in Asian countries during the 1970s and 1980s led to substitution of financial for nonfinancial forms of saving. Greater availability of facilities and more choice of financial instruments over the past two decades have been a powerful stimulus for increased saving. Some of the changes include: (a) the spread of commercial bank offices, post office savings banks, cooperatives, credit unions, savings and loan associations, development banks, investment and unit trusts; (b) an increase in the volume and variety of financial assets available to savers; (c) a rise in the degree of monetization of the rural economy associated with the spread of commercial agriculture; and (d) greater access to credit from formal sector institutions.

This widening and deepening of the financial system has allowed greater and more productive investment to occur, a change most noticeable in the household sector and with private business corporations. Government investment has also been routed through the financial system in Korea, India, and Sri Lanka, though the uses of funds have not always been efficient. In general, financial intermediation has greatly increased, leading to a virtuous cycle of higher saving, improved investment efficiency, and higher real economic growth.

External Financial Flows and External Debt

GNP growth, if it depends on imports, is limited by the availability of foreign exchange. By deregulating the interest rate, the NICs and ASEAN-4 have been successful at mobilizing domestic resources, saving some 30 percent of GDP in the case of the NICs. The NICs were able to put foreign exchange earnings resulting from exports to use to purchase inputs. Domestic capital accumulation greatly reduced their need to borrow abroad for investment. By 1980, even the South Asian countries of India and Sri Lanka increased their savings rates to 20 percent. Still, their investment exceeded savings. In consequence, large foreign debts have been accumulated by Korea, Indonesia, Malaysia, Thailand, India, and the Philippines.

Current account deficits in most Asian developing countries resulted in part from the large oil price shocks that occurred in 1973–74 and 1979–80. There is also evidence that booming investment—particularly in the late 1970s—played a substantial role. In some cases (e.g., the Philippines) public expenditures grew much faster than revenues, and widening fiscal deficits were financed by foreign borrowing.

Policy Initiatives for Adjustment. The long-term debt repayment capacity of the NICs, and Korea in particular, appears to be adequate. But the ASEAN-4 countries face considerable difficulties in debt servicing and will continue to need inflows of Official Development Assistance (ODA) to maintain their growth momentum, though the longer-term trend toward an increasing share of private capital inflows will likely continue. The South Asian countries will continue to rely overwhelmingly on ODA, but most of them will also look more to private sources for external finance.

Foreign Direct Investment. Japanese and U.S. investment together have accounted for more than one-half of total foreign direct investment in the NICs and the ASEAN-4. However, this combined share is much smaller in the South Asian countries for which information is available. In addition, the U.S. appears to be the largest single investor in all NICs and ASEAN-4 countries except Korea and possibly Malaysia.

Foreign capital and technology has been especially important in the development of natural resources in Southeast and South Asia and is likely to become even more significant. Slower growth of official development assistance and the high costs of external commercial loans make foreign direct investment an attractive source of such capital and technology. The costs of resource extraction and development of related industries are often too great for internal financing in these countries. Specifically, foreign direct investment could be helpful in the development of Thailand's offshore natural gas, India's offshore oil, Burma's gas and oil, Nepal's minerals and hydropower resources, and Indonesia's minerals, and geothermal and hydropower potentials.

Asian Agriculture in Transition

Three major factors have contributed to the upsurge in foodgrains production in Asia.

- The most important factor has been the rapid dissemination of modern high-yielding seed varieties—sometimes even exceeding the rates achieved by more developed nations.
- The second major factor has been the greater use of chemical fertilizers.
- The third major component has been the large-scale expansion of irrigation systems, combined with massive rehabilitation and improvement of existing irrigation systems.

Rice is by far the most important crop in Asia, in terms of land area, production value, and impact on employment, incomes, and nutrition. Of the total cereals area harvested in 1983 in Asian LDCs (178 million hectares), over half was accounted for by rice, about a fifth by wheat, and one-tenth by maize. Rice imports into South and Southeast Asia fell from almost 9 million tons per year in the mid-1970s to less than 1 million tons in the early 1980s, as total production rose from 140 million tons per year to 190 million tons. By the mid-1980s production exceeded 210 million tons, and Asia had a substantial surplus of rice.

Wheat, the second most important cereal crop in Asia, showed even more impressive growth. Wheat production was up by almost 110 percent in the five major producing countries (South Asia, excluding Sri Lanka) between 1973 and 1984, a growth rate in excess of 7 percent a year. Net imports of wheat in normal crop years in wheat-growing South Asia declined significantly in that period.

The production of maize expanded by over 30 percent in the 1970s. Indonesia, the Philippines, and Thailand had high rates of growth owing to both area and yield increases. Thailand, in fact, emerged in the late 1970s as a substantial net exporter of feed corn.

Noncereal Crops. The noncereal crops range from pulses and rootcrops often produced for subsistence purposes by low-income limited resource farmers in rainfed plots to a variety of tree crops, fibers, and horticultural products sometimes produced by highly commercialized agribusiness firms or modern plantations. A number of cash crops are simultaneously raised by smallholders and on modern estates (rubber, cocoa, coconut, sugar, tobacco, cotton, jute). Usually the estates generate higher yields and better quality, though they are not necessarily more efficient than smallholders when economic costs and returns are considered.

The share of noncereal crops in agricultural GDP varies among countries, but it accounts for 20 to 30 percent of total agricultural output in South and Southeast Asia. Noncereal crops account for a considerably larger share of agricultural exports than do cereals. In Taiwan and Korea the noncereal crop sector is smaller, and accounts for a lower share of agricultural exports, than in South Asia or the ASEAN-4 countries.

The ASEAN-4 countries had higher growth in production of noncereal crops particularly major export crops (palm oil, rubber, coconut, coffee, sugar) than did South Asian countries in the 1970s, which contributed to stronger overall growth of agricultural production and exports there. These countries had more abundant land resources than South Asia or the NICs for expansion of noncereal crops; they also did more to promote noncereals crop production, and their policies left agricultural product and factor markets relatively undistorted. This allowed a degree of diversification to occur in response to market incentives.

Livestock, Fisheries, and Forestry. Livestock are an integral component of smallholder agriculture throughout Asia. The larger animals (buffalo, cattle) are valued more as a source of draft power, manure, and transport than as a food source in low-income rural areas.

In most of Asia, cattle and dairy production are constrained by the scarcity of land for grazing purposes. Technical services are less developed and there are problems of disease that adversely affect size and quantity. On the demand side, consumption of meat, milk, and eggs is very low, though income growth has increased demand for these income-elastic products, particularly in the NICs and more prosperous parts of South and Southeast Asia. The production of poultry and pork has increased rapidly in South and Southeast Asia, but overall the livestock sector has been lagging and its share of agricultural GDP has been stagnant or declining.

In contrast, fisheries production has been among the most dynamic aspects of Asian agriculture. Total fish production of the Asian developing countries doubled between 1965 and 1982, and their share in total world production increased from 12 to 20 percent. This rapid growth provides employment opportunities, brings in foreign exchange, and increases protein supplies to consumers. Fishery products provide the main source of animal protein consumed in most Asian countries.

Marine production accounted for four-fifths of the export total. The extension of exclusive economic zones has changed the distribution of marine resources, expanding opportunities for some countries and reducing them for others. Overfishing and pollution have become problems in many areas. Freshwater capture fisheries have been adversely affected as well by population pressures, and production has stagnated. Promisingly, aquaculture technologies for development of high-yielding fishponds present new opportunities for expansion of production in Asia.

The size and importance of forestry as an economic activity varies enormously within the Asian LDCs, reflecting the uneven distribution of forest resources. Overall, the share of forest product exports in total agricultural exports fell from one-fifth in the late 1970s to one-seventh in the 1980s. This decline happened not only because of depressed prices in overseas markets, but because of rapid depletion of forests. In the mid-1980s, annual deforestation in Asia was estimated at over ten million hectares—a rate in excess of 3 percent. Thailand, for example, used to be a major exporter of hardwood logs, but it must now import a major part of its lumber; rapid expansion of agricultural land for farming has all but eliminated the rain forests there. The Philippines is also expected to become a net importer of wood by the early 1990s, if not before, and even Malaysia and Indonesia are encountering difficulties in supplying wood processing industries with raw materials.

Hunger for land, demand for fuelwood, carelessness, and the pursuit of quick short-term profits have all contributed to the degradation of Asia's forests. The high costs of wanton deforestation include reduced overall agricultural production in the long term.

Assessment of Agricultural Policies. The improvement of agricultural production in Asia between the mid-1960s and the mid-1980s occurred in large part because of the types of policies adopted by governments. Policy changes have been instrumental in improving both the incentives to produce and the capacity of the sector to respond. Advances in technology, large investments in infrastructure, institutional reforms, and increased human capital formation have all contributed to Asia's agricultural performance. The macroeconomic environment has also played a strong role in agricultural development.

Technology, Infrastructure, and Institutions. Massive investments in improving rural infrastructure—irrigation, roads, communications, electrification, health and educational facilities—were undertaken during the 1970s across rural Asia, paralleling the green revolution and the development of new seed varieties.

Governments introduced reforms to provide greater access to credit and greater security of tenure. Rural financial institutions were expanded and provided a larger share of farm credit. In Korea and Taiwan, banking institutions provided two-thirds of farm credits by the late 1970s; in Thailand the share of farm credit from institutional sources rose from 7 percent in the mid-1970s to almost two-thirds by 1981. The share of institutional finance was lower in South Asia, but it rose gradually during the 1970s.

Making rural credit available to small farmers caused a number of unexpected problems, but rural financial institutions in South and Southeast Asia have considerably improved their performance as they have built up expertise in lending. These institutions are now placing greater emphasis on attracting savings deposits.

Land reform legislation in Asia has been aimed at preventing concentration of land ownership and at protecting the rights and security of tenant farmers. It was notably successful in Taiwan and Korea, but less so in South and Southeast Asia. In the latter countries, estimates of idle or surplus land were sometimes exaggerated. In none (outside Korea and Taiwan) was as much as 5 percent of the land transferred to the landless. Land reform laws, at best, may have helped slow the trend toward increasing concentration of land holdings in parts of South and Southeast Asia.

Factors other than institutional reform have been more important in reducing rural poverty in Asia: the spread of educational facilities, improvements in health and nutrition, and development of skills through vocational training are some. The development of nonagricultural activities in rural areas and the growth of off-farm employment has transformed many rural communities.

Future Problems and Prospects. Agricultural production achievements in the 1980s have been spectacular in most of Asia. By the middle of the decade a huge surplus of rice had led to falling real food prices; a number of countries that had had serious deficits in cereals production during the mid-1970s—Indonesia, India, Sri Lanka—suddenly had to cope with the problem of disposing of surplus production. Countries that traditionally have exported rice—Burma, Thailand, and Pakistan—will have to deal with shrinking markets in the coming years.

Improved cereals production means that Asian countries will have to establish new priorities for agricultural development. Diversification of agriculture, however, requires a technological and infrastructural base that is more complex than that needed for foodgrains alone. Of the ASEAN-4 countries, Thailand and Malaysia have successfully established the underpinnings for a diversified agriculture. They have adapted to changing international markets and shown an ability to export a wide range of processed and semi-processed agricultural goods in addition to staples. But other ASEAN and South Asian countries will have to reorient agricultural policies (and "macro prices") to provide suitable incentives for shifting resources from cereals to other crops.

The success with rice and wheat has stimulated policymakers to advocate expansion of the green revolution to unirrigated and upland farms. But because cropping patterns and environmental conditions are far more varied and complex outside of the rice plains, it will be more difficult to repeat past success. The "package" approach to technology and inputs that worked for rice is not likely to be feasible for limited resource farmers in rainfed and upland areas of rural Asia, where development will depend on location-specific research and even greater reliance on market signals. Reforestation and soil protection programs that allow upland farms to prosper require innovative research and creative implementation. Upland farmers can supply Asian urban centers with a variety of products—vegetables, fruit, dairy and livestock products, tree crops—that have higher income elasticities of demand than cereals or other staples. The markets for these goods have improved and will continue to grow in the future.

Trade conflicts have emerged between Asian exporters and the developed countries. Protection of domestic agriculture and subsidies to exporters have been combined by a number of European countries; Japan's market for many agricultural goods is highly protected; and the United States, in adopting export subsidies in order to compete with European exporters, has harmed Asian primary exporters. The reversal of protectionism would greatly facilitate agricultural diversification in Asia. Asian countries could then benefit from inexpensive imports of temperate zone products and expand exports of a variety of processed and semi-processed tropical goods.

Human Resource Development

Rapid population growth burdens economic development efforts. Although low-income countries in Asia have managed to reduce their birth rates, family planning programs still deserve high priority. The success of family planning programs in some Asian LDCs suggests that there is widespread willingness to adopt birth control measures; these measures must be widely available, at low cost, and easy to apply. For Asian countries with higher growth rates, priority in population policy should be given to the expansion of educational and job opportunities. These changes will indirectly lead to lower birth rates.

The lower-income Asian countries should devote a larger share of government expenditure to general public education. In South Asia, greater emphasis should go to primary education as compared to higher education; in the middle-income ASEAN-4 countries, there is need for vocational and technical courses in secondary schools to improve job opportunities for students. Rapid expansion of higher education without careful evaluation of priorities is dubious policy: university graduates in a number of South Asian and ASEAN-4 countries are finding it hard to obtain suitable employment.

With respect to public health and nutrition policies, there is much to be done in the low- and middle-income countries of South Asia and the ASEAN-4. Preventive measures are far more cost-effective than curative efforts. It is essential that public health services reach poorer individuals and those in outlying areas. Village-based programs combining health care and family planning can be very effective.

The ability of low-income South Asian countries to accelerate their development hinges on reducing population growth through more rapid declines in fertility rates so that human "capital-deepening" can occur. The processes are mutually reinforcing when they are in operation over long periods: lower population growth allows more investment per person, which in turn causes faster per capita income growth and further reductions in fertility.

The remarkable achievements of some of the low-income countries of Asia (India, Sri Lanka) in slowing population growth give hope that the future development of these economies can be the next economic success story in Asia. Much remains to be done even in countries as advanced as those of the ASEAN region, where high population growth rates in the past have created a labor force explosion in the present. Employment-focused development programs must operate to reduce supply as well as to increase demand for labor. The NICs illustrate this double success in conquering the employment problem.

In order for the Asian LDCs to realize their potentials, fuller use of human resources must be made. Policies need improvement; institutional advances are essential. Governments must improve their own learning and implementation capacities if their policy reforms and innovations are to succeed.

Policy Lessons and Future Prospects

The Role of Government. Government involvement in reducing the uncertainty facing businesses and in providing support for innovation has been important, particularly for the NICs. The role of governments in the rapid industrial growth of those countries, with the possible exception of Hong Kong, seems to have been much greater than that allowed for by neoclassical economics. But the manner and effects of state intervention there also appear to be quite different from the frequently adversarial government-business relations found in the West. The central motive behind government intervention in the NICs has been to spur economic growth. Growth and exports are the yardsticks of success in those societies.

The criticism of neoclassical economics that it plays make-believe in explaining the success of the Asian NICs by extolling their reliance on the market while neglecting the visible hand of state industrial policies and active export promotion is only half true. Many "neoclassicals" are keenly aware that the NICs' planning agencies, such as Japan's Ministry of Trade and Industry (MITI), have tried to pick the winners and provide them support through access to credit, duty-free imports of equipment, export subsidies, insurance, transport preferences, and so forth. They do not suggest that the governments of Japan and the NICs are uninvolved, but neither do they go to the opposite extreme and credit these governments as the sole architects of success. The governments of these countries have relied on markets to a large extent, and human resource policies and the presence of entrepreneurs have also been vital institutional ingredients to successful development.

The NICs did take somewhat of an interventionist approach in selectively promoting labor-intensive manufacturing in the 1960s and early 1970s. Their decision to develop these kinds of exports was practical and had beneficial side effects: it reduced unemployment and improved income distribution. Singapore and Korea excessively promoted heavy industries (e.g., ship building, petrochemicals, integrated circuits) in the late 1970s and early 1980s, and they both had near disasters as a result. When the NICs have moved away from outward-looking market-oriented policies they have had problems, slowing their economic growth and increasing income inequalities. Governments find it increasingly difficult to guide and direct industrial development as an economy becomes more complex. The integration of the NICs' industries into world and regional economies is essential to their long-term growth. Achievement of better integration requires less direct government intervention and greater reliance on private initiative and market forces. Greater freedom would allow foreign investors and domestic entrepreneurs to establish links, adapt technologies, and develop markets.

The relatively sound macroeconomic policies and undistorted prices in the NICs' economies will permit the governments in Singapore and Korea to overcome quickly the mistakes they made in excessive promotion of inappropriate heavy industries. Loss-making (sunset) industries will not be perpetuated indefinitely through subsidies or conversion into public enterprises that drain the budget. The NICs have shown the flexibility to phase out losers so that scarce resources are released for new endeavors.

The theory of industrial organization allows the extension of neoclassical economics to include the role of direct government intervention in promoting economic growth and development. In the NICs (and Japan) powerful government agencies charged with responsibility for overseeing economic planning, trade, and industrial development have forged close relationships with the private business sector. The hierarchical relationship between these agencies and private business, and the coincidence of objectives between government and business leaders, facilitates the efficiency of policy implementation. Government and business, instead of behaving like adversaries, act as if they were linked in a "quasi-internal organization." Government support in the context of an outward-looking strategy helps to encourage risk-taking and innovation by business, while the hierarchical relationship allows coordinated and timely responses to unforeseen contingencies.

The close working relationship between government and business in the NICs and the high degree of professionalism in the ranks of the civil service are well known. One need only compare the record of land reform implementation in Taiwan, Korea, and Japan with that of the Philippines and India to appreciate the differences in governmental efficiency. The prevalence of corruption and inefficiency in the civil service of most ASEAN-4 and South Asian countries increasingly has been the target of outspoken criticism from reform-minded political leaders. The honesty and efficiency of government and the likelihood that it will be able to correct market failures and intervene in a manner that improves the well-being of society are closely related.

The high cost of government failure has given impetus to moves toward greater reliance on market forces and the private sector in most South Asian and Southeast Asian countries, as well as in China. These moves are accompanied by efforts to improve government institutions and the skills and abilities of government employees. Technocratic and economic measures of success are adopted only slowly in countries where patronage and nepotism are the prevailing standards.

Government efficiency can also be measured in more mundane terms, such as the ability to provide local public goods and services—potable water, sewage systems, roads, public health facilities, and public schools. In the NICs, governments have proved successful in mobilizing resources and allocating them effectively at the local level. These governments have done well in providing the basics—law and order, public goods, and defense. Sadly, in much of South Asia limited government resources have been squandered all too often on capital-intensive public enterprises at the cost of neglect of basic services, infrastructure, and public security. The improved quality of human resources has been central to the success of the NICs (and Japan). The slower-growing economies in Asia have been those in which returns on expenditure of energy and time have been, on average, higher in rent-seeking and redistributional activities than in the creative responses to disequilibrium stressed by human capital theorists.

Future Prospects: Renewed Growth or Stagnation? The difficulties Asian countries experienced in the 1980s are mainly the result of inadequate domestic policy responses to changing world economic conditions and the failure of some countries to make necessary structural changes in the 1970s. The lesson to be learned from slower growth in the 1980s is that outward-looking development strategies will continue to perform better than inward-looking ones. Those countries that have taken steps to become more open and market-oriented in the 1980s, like some of the South Asian countries (and China), have improved their growth rates.

The slowdown in world economic activity in the 1980s exposed a number of structural weaknesses in the ASEAN economies. And although the South Asian countries performed creditably in terms of economic growth, they also have glaring structural problems.

The ASEAN-4 countries relied excessively on external borrowing to propel growth in the late 1970s and early 1980s. Their failure to translate enough of these publicly guaranteed borrowings into viable investments that generate foreign exchange earnings and savings has forced them to reduce expenditures and cut imports. Positive adjustment policies are needed to promote export-oriented and labor-intensive activities, to encourage greater savings, better revenue collection, and more efficient investment and expenditure programs. Given their heavy debt burden, without meaningful policy change it is unlikely that these countries will be able to restore growth.

The South Asian countries have extremely large trade and budget deficits, and their reliance on foreign funds for domestic investment has increased. Employment and poverty problems are even more severe than in the ASEAN-4. Yet after experimenting since the late 1970s with policy reforms to make it less costly to trade, the South Asian countries have achieved higher growth rates. They have turned the corner in solving the problem of enough agricultural production, and are able to diversify rural activities as the ASEAN-4 began to do in the 1970s.

The NICs are undergoing a process of change in several important directions. Structurally, they are becoming more like advanced industrial-service economies. Agriculture's share of income and employment is very small except in Korea, where it is falling rapidly. Manufacturing activities are becoming more sophisticated and skill-intensive, and the composition of exports will reflect this transition. The export of heavy industrial products and differentiated consumer durables, including automobiles and personal computers, finds the NICs emerging as competitors of Japan in some areas.

At the macroeconomic level, led by Taiwan, the NICs are becoming net capital exporters. Trade surpluses and an excess of domestic saving over investment are expected to continue and grow. Korea will have the means to reduce the growth and then the size of its external debt, and other countries will have increased funds for foreign direct and portfolio investment. The smaller NICs will have to devise investment strategies to take advantage of their transition, for there are too few domestic investment opportunities in those countries. The relocation of more labor-intensive industries to other parts of Asia will be an important part of the NICs' reorientation from export- or trade-oriented to investment-oriented economies. Japan has already begun this process with the internationalization of Tokyo's financial market. Increased financial and investment links will accelerate the process of industrial restructuring throughout Asia.

New Challenges to Asian Development. One challenge facing numerous Asian countries is that of making smooth transitions from old to new political leaderships, a difficulty that threatens political stability from Korea and Taiwan in the East to Pakistan in West Asia. In some countries there is no generally accepted institutional mechanism in place for political succession. Several countries are in danger of conflict as a result of their failure to legitimate the process in the eyes of their citizenries. Ethnic, regional, and religious conflicts add to the political tensions, particularly the in South and Southeast Asian countries. Unless these problems are successfully handled, serious disruption of economic development is likely. Politically induced economic crises have already occurred in the Philippines and Sri Lanka and have threatened Pakistan, India, Bangladesh, Indonesia, and Malaysia.

The other major internal challenge involves the management of structural change in a positive manner. In several Asian developing countries, governments have initiated effective programs to liberalize imports, investment regulations, and financial markets, and to reduce budgetary deficits. Structural adjustments at both the macro and micro levels are necessary to restore sustainable growth in Asian countries with large external debts or with excessive current deficits. At the macro level, exchange rates must be adjusted and then maintained at appropriate levels to encourage exports, investment must be given proper emphasis, and monetary-fiscal policies must be balanced to keep inflation low to moderate. At the micro level, it is necessary that trade restrictions be reduced, the price system be allowed to operate more freely, financial systems be developed, and public enterprises be made more efficient, in some cases by selling them to private investors.

Positive adjustment entails achievement of a sustainable balance-of-payments position with export, employment, and income growth. Economic growth should also be accompanied by social and human resource development.

For structural adjustment to succeed, the Asian developing countries must continue to have access to the markets of the more-developed countries. Improved international relations require concessions on the part of both the more- and less-developed countries. The increasing interdependence between the Asia-Pacific region and the world economy is widely recognized: the severe recession and international debt crisis of the 1980s for example has led the United States and Japan to present complementary plans to assist the indebted developing countries in order to renew economic growth. At the same time that expanded programs of financial assistance are enacted through the World Bank, IMF, and other international agencies, it will be essential that the basic framework for an open system of international trade and investment be strengthened. Financial packages will be unsuccessful unless trade expansion is forthcoming.

Regional groupings like ASEAN and the newly-formed SAARC (South Asian Association for Regional Cooperation) can be more effective in promoting developing countries' interests in a stronger system of open trade than in a closed and protectionist system. These groupings could begin by doing more to liberalize member countries' own trading and investment practices so they more closely conform to international rules and standards. This would do much to revitalize cooperative efforts, and would accelerate trade and other ties between member countries.

There is vast potential for increased beneficial investment and trade linkages between the developing countries in the region and also between developed and developing countries. The United States and Japan, as well as Australia and New Zealand, can provide new technology, capital, and supply sources for new products, as well as energy and other resources. They can also provide large markets for tropical resource-based products and manufactured exports of the developing Asian countries.

The appreciation of the Japanese yen against the dollar and most currencies of the other Asian countries since late 1985 has made the manufactured exports of the NICs, ASEAN-4, and South Asian countries more competitive. Even prior to the higher yen, the NICs and ASEAN-4 were gaining competitive strength in a number of manufacturing sectors relative to Japan.

The yen's appreciation, if sustained, will also lead to a substantially greater source of inputs and components by Japanese industry in other Asian countries. The yen appreciation is not all favorable for the NICs, ASEAN-4, and South Asian countries. A large share of their imports are capital goods, consumer durables, and other producer goods from Japan. They will continue over the medium term to require spare parts and other imports from Japan, and these will be more costly. Those that have borrowed in yen-dominated instruments will face higher debt-servicing costs. But the realignment of the yen will also make U.S. machinery and equipment more competitive and thereby should help ease trade frictions between Asian developing countries and the United States.

The NICs are emerging as new sources of finance and standard technologies useful to ASEAN and South Asian countries. They, like Japan, are large net importers of resources and resource-based products;

and their complementary relationship with ASEAN and South Asia can be developed further. There is also scope for expanding ties among South Asian countries and between South Asia and the ASEAN region.

The emergence of China after decades of self-imposed isolation is in no small way related to the rapid economic development occurring in neighboring countries. China's open-door policy introduces a new element of dynamism and a new source of competition, particularly for countries promoting labor-intensive manufactured exports. China's rapid economic growth following its adoption of policies to provide incentives to farmers and to encourage profit-making and exports again demonstrates the lessons of Asian development. Ultimately, the future of Asian development will depend on the conversion of good policy analysis into good policymaking. Broadly speaking, government policies have been adjusted in the proper direction: encouraging exports, liberalizing imports, enhancing domestic savings, and relying more on private business and markets to allocate resources. In the past, economists have underestimated the ability of the Asian countries to adapt to changing conditions. We do not wish to gloss over the difficulties these countries face in sustaining satisfactory growth rates, but the fact remains that development progress of countries like Thailand, Korea, Taiwan, Hong Kong, Singapore, Indonesia, and Malaysia has regularly exceeded expectations of policymakers and economists. South Asian countries formerly regarded by smug Western politicians as "basket cases" have shown great resilience. The Philippines' remarkable democratic revolution has at least increased its chances for an economic recovery and renewed growth with more equity.

The major policy challenge for the remainder of this century is for the Asian countries to restore growth and simultaneously to raise the quality of economic growth. For South and Southeast Asian countries, economic growth must be intensive in employment creation and balanced between rural and urban communities. Improvements in environmental conditions and increased investment in human resources can raise the quality of life. Development efforts must also rely more on domestic savings than on foreign borrowing. External resources will still be necessary; direct foreign investment and other forms of equity finance are likely to increase in importance.

We have continually stressed the importance of domestic policies for optimal development. Yet it is undeniable that the basis of Asian success in economic development has been the growth of international economic relations. This very growth has magnified the economic interdependence of all countries in the region. The prospects for further progress in economic development of the region, therefore, depend in large part on a conducive international environment. The developing Asian countries have turned increasingly in the direction of greater openness and increased freedom for markets, and it is in the interests of the more-developed countries to nurture this process by every means at their disposal. Adoption of policies that favor the growth of international economic relations will allow the greatest improvement in living standards throughout the region.

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